BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
KNOLL PHARMACEUTICAL COMPANY, INC.)

For Appellant: Byron J. Massey
Attorney at Law

For Respondent: Bruce W. Walker
Chief Counsel

David M. Hinman
Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Knoll Pharmaceutical Co., Inc., for refund of tax in the amounts of $1,692.08, $1,185.64, and $462.46 for the income years 1970, 1971, and 1972, respectively, and

pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Knoll Pharmaceutical Co., Inc. against a proposed assessment of franchise tax in the amount of $200.00 for the income year 1973.

Appellant is a New Jersey corporation engaged in the manufacture and sale of drugs. Appellant has no offices and owns no real property in California. Appellant employs eight detail men to solicit orders from customers in California. The detail men are paid by appellant and operate out of their own homes. They do not accept deposits, make collections, or receive goods for delivery. The orders solicited by appellant's detail men are not submitted to appellant's New Jersey office for approval or rejection. Rather, the orders are transmitted to appellant's consignee, Obergfel Brothers Co. (Obergfel) for approval and acceptance at its Los Angeles headquarters. Obergfel is a warehouser, seller and distributor of the pharmaceutical products of a number of drug manufacturers including appellant. Appellant regularly ships goods on consignment to Obergfel, but does not ship goods directly to its California customers. After an order is approved and accepted by Obergfel it is filled from the stock of appellant's goods regularly maintained at Obergfel's location for this purpose. Obergfel bills the purchasers of appellant's goods and collects all accounts in its own name, assumes all credit and drug-law compliance risks, and remits to appellant on a monthly basis the proceeds from sales of appellant's products, less discounts, allowances and commissions. Obergfel also sells appellant's products on its own.

For the income years 1970 through 1973, appellant filed California corporation income tax returns. It paid tax for 1970 through 1972. Since appellant incurred a net loss for 1973, it paid no tax for that year. Subsequently, appellant filed claims for refund for the income years 1970 through 1972 on the grounds that it was not subject to California tax. Respondent determined that appellant was doing business in California and was, therefore, subject to the franchise tax. Accordingly,. respondent denied appellant's claims

for refund for the income years 1970 through 1972, and issued a notice of proposed assessment in the amount of $200, the minimum franchise tax, for the income year 1973. Appellant protested the proposed assessment and respondent denied the protest. Appellant brings this appeal from respondent's action.

This appeal presents two issues for resolution: (1) whether appellant is subject to the California franchise tax, and (2) whether appellant is provided immunity from the franchise tax by Public Law No. 86-272. (73 Stat. 555 (1959), 15 U.S.C. § 381.)

The franchise tax is imposed upon domestic corporations and foreign corporations which are "doing business" in this state for the privilege of exercising their corporate franchise in California. (Rev. & Tax. Code, § 23151.) "Doing business" is defined as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. (Rev. & Tax. Code, § 23101.) If appellant is doing any intrastate business within this state, it is subject to the' franchise tax measured by its net income attributable to sources within the state, regardless of whether the income is derived from intrastate or interstate commerce. (See generally, Matson Navigation Co. v. State Board of Equalization, 3 Cal. 2d 1 [43 P.2d 805](1935), aff'd 297 U.S. 441 [80 L. Ed. 791](1936); Underwood Typewrite; Co. v. Chamberlain, 254 U.S. 113 [65 L. Ed. 165](1920).) The simple but controlling test is whether the state has given anything for which it can ask return. (General Motors Corp. v. Washington, 377 U.S. 436, 441 [12 L. Ed.2d 430](1964).)

More specifically, respondent's regulations provide that a foreign corporation engaged entirely in interstate commerce is not "doing business" in this state and is not subject to the California franchise tax. (Cal. Admin. Code, tit. 18, reg. 23101; but see Complete Auto Transit, Inc. v. Brady, ___ U.S. ___ [51 L. Ed. 2d 326](1977).) The same regulation also provides that a foreign corporation which maintains a stock of goods in the state pursuant to orders taken by employees in this state is "doing business" and its entire income

from sources within California is subject to the franchise tax. Respondent's regulations provide further that:

> Foreign corporations do not become subject to the franchise taxes simply because they send goods to California dealers or brokers on consignment or because they maintain stocks of goods here from which deliveries are made pursuant to orders taken by independent dealers or brokers. Such corporations, however, are subject to the income tax, since a portion of their income is attributable to the investment represented by the property located in this State.
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> Foreign corporations which make deliveries from stocks of goods located in this State pursuant to orders taken by employees in this State are engaged in intrastate business in this State and are subject to the bank and corporation franchise tax, even though they have no office or regular place of business in this State. Foreign corporations which have employees in this State engaged in providing personal services other than in interstate commerce are engaged in intrastate business in this State and are subject to the bank and corporation franchise tax, even though they have no office or regular place of business in this State. Corporations described in this paragraph are doing business in this State. They are not within the purview of Section 101(a) of Public Law 86-272, supra. (Cal. Admin. Code, tit. 18, reg. 23040(b).)

Here, appellant has gone farther than merely sending goods to its California consignee which, standing alone, would not subject it to the franchise tax. Additionally, appellant employs detail men to solicit the sales of its products. These sales are not approved and accepted by appellant at its out of state headquarters, but are approved and accepted by appellant's consignee Obergfel. Furthermore, the orders

solicited by appellant's detail men are filled by Obergfel from a stock of goods maintained in this state for that purpose to which appellant retains title. Collectively, these activities constitute "doing business" in California and are sufficient to subject appellant to a properly apportioned franchise tax. In effect, appellant's local employees and the stock of goods owned by appellant and maintained in California have received the benefits and protection for which the state can ask a return.

Next, we turn to the question of whether appellant is immune to the franchise tax by virtue of Public Law 86-272. Public Law 86-272 provides, in relevant part:

> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
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> (1) The solicition of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
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> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).
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> (C) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consists solely of making sales, or soliciting orders for sales, of tangible personal property.

It is apparently true, as appellant asserts, that this is a matter of first impression. Accordingly, prior decisions applying the immunity provided by Public Law 86-272 are of limited assistance. However, we do note that, in enacting Public Law 86-272, Congress carved out a specific area of immunity from state taxation which the courts have strictly limited to solicitation or activities incidental thereto. (See Herff Jones Co. v. State *Tax* Commission, 247 Ore. 404 [430 P.2d 998](1967); Cal-Hoof Wholesale, Inc. v. State Tax Commission, 242 Ore. 435 [410 P.2d 233](1966).) Not only must the foreign corporation's activities be limited to solicitation and incidental activities, but subsection (a)(1) of the statute also requires that the orders be sent out of state for approval and filled from a point outside the state.

'In the instant matter the *orders* submitted by appellant's detail men are not sent outside the state for approval or rejection as required by subsection (a) (1) of the statute. Instead, they are submitted to appellant's consignee Obergfel in Los Angeles who is charged with the responsibility for approving or rejecting those orders. Additionally, the orders are not filled by shipment from outside the state as required by the same subsection. Again, it is Obergfel that fills the orders from a stock of appellant's goods maintained in this state for that purpose. We conclude that appellant's activities in California have exceeded the statutory minimum and that it cannot qualify for the protection of Public Law 86-272. (See Lohr-Schmidt, Developing Jurisdictional Standards for State Taxation of Multistate Corporate Net Income,

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22 Hast. L. J. 1035, 1067-68(1971); Sabine, Constitutional and Statutory Limits on the Power to Tax, 12 Hast. L. J. 23, 28 (1960); Note, State Taxation of Interstate Commerce; Public Law 86-272, 46 Va. L. Rev. 297, 318 (1960).)

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Knoll Pharmaceutical Co., Inc., for refund of tax in the amounts of $1,692.08, $1,185.64, and $462.46, for the income years 1970, 1971, and 1972, respectively: and pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Knoll Pharmaceutical Co., Inc., against a proposed assessment of franchise tax in the amount of $200.00 for the income year 1973, be and the same are hereby sustained.

Done at Sacramento, California, this 28th day of June, 1977, by the State Board of Equalization.

, Chairman

, Member

, Member

, Member

, Member